

# What All Employers Should Know About Disaster Relief Funds to help with COVID-19

*April 1, 2020 – Dorsey Health Law*

by Claire H. Topp and Mackenzie McNaughton

The COVID-19 pandemic is placing new and unprecedented demands on both taxable and tax-exempt employers and their employees. One option many employers may not have previously considered is the use of a tax-exempt employee assistance fund. Depending on the structure of the fund, declaration of qualified disaster is an important requirement for the fund to issue financial assistance to individuals.

Although the Internal Revenue Service (“IRS”) has yet to issue official guidance confirming the COVID-19 pandemic as a “qualified disaster” under Section 139 of the Internal Revenue Code (the “Code”), the President declared a national emergency under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (“Stafford Act”) due to extraordinary circumstances resulting from COVID-19. A qualified disaster relief payment is defined under Section 139(c)(2) of the Code to include a federally declared disaster as defined by Section 165(i)(5)(A) of the Code, which defines the term as any disaster subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Stafford Act.

If employers do not already have an established employee assistance fund, deciding and implementing the most beneficial structure during a crisis can seem daunting. We have experience forming and implementing employee assistance funds, and quickly and efficiently navigating the application for tax-exempt status with the IRS. Below is an overview of issues employers should consider when contemplating a new employee assistance fund program.

## *What is an employee assistance fund?*

The term employee assistance fund (“EAF”) is generally used to describe several types of employer-sponsored Section 501(c)(3) (all subsequent references to “Section” shall mean Sections of the Code) charitable tax-exempt organizations designed to provide emergency, need-based financial assistance to an employer’s work force in the event of disaster or personal hardship impacting individual employees or their families. EAFs are

## Related People

- Claire H. Topp

## Related Capabilities

- Healthcare & Life Sciences
- Healthcare Transactions & Regulations
- Healthcare Litigation
- Medical Devices

typically structured as a public charity, a donor advised fund, or a private foundation. A Section 501(c)(3) EAF must serve a charitable class, which must be large enough or sufficiently indefinite that the community as a whole, rather than a pre-selected group of people, benefits from the EAF grants. EAFs may restrict benefits to a certain company's employees and still serve a charitable class so long as the EAF's assistance policy is open-ended and include employees affected by any current or future disasters or emergencies.

*What are the distinguishing characteristics of an EAF structured as a public charity?*



An EAF established as a public charity described in Sections 509(a)(1) and 170(b)(1)(A)(vi) receives its funding primarily through donations from the general public, usually through donations from the company's individual employees. A public charity EAF can provide financial assistance in

response to any type of disaster or employee emergency hardship, so long as the related employer does not control the organization. Generally, these requirements are met when non-executive (i.e., rank and file) employees comprise a significant portion of both the board of directors and the committee that selects eligible individuals for need-based distributions from the EAF. Unlike a donor advised fund or a private foundation, a public charity EAF can provide assistance to eligible individuals in response to any type of disaster or employee emergency hardship situation.

*What are the distinguishing characteristics of an EAF structured as a donor advised fund?*

A donor advised fund is a community foundation-type of organization that maintains separate funds or accounts on behalf of individual or corporate donors. The donors then receive advisory privileges over the distribution of the donated funds, but such distributions must still be made for charitable purposes. While a donor advised fund is usually classified as a public charity, important distinctions for donor advised EAFs are subject to additional restrictions. Typically, a donor advised fund (whether or not an EAF) cannot make grants to individual persons. However, a donor advised EAF can make grants to individual employees and their family members if:

- the EAF makes need-based distributions adequately documented by the EAF;
- the EAF's sole purpose is to provide relief after a qualified disaster as defined in Section 139; and
- eligible recipients are selected by a committee independent from the sponsoring employer.

*What are the distinguishing characteristics of an EAF structured as a private foundation?*

EAFs structured as private foundations are typically funded solely through donations by an employer, and not by contributions from individual employees or the general public. Like the donor advised EAFs, an EAF structured as a private foundation may only provide need-based assistance to employees or family members impacted by a qualified disaster as defined in Section 139. Also, the private foundation EAF's selection committee must be independent from the employer, and payments to or for the benefit of individuals who are directors, officers, or trustees of the private foundation may subject the foundation to the self-dealing rules under Section 4941.

*Are payments from an EAF taxable to the individual recipients?*

No. Payments from a Section 501(c)(3) EAF as a result of a disaster or emergency hardship are considered to be gifts and are excluded from the recipient's gross income under Section 102.



*Are disaster relief payments taxable if received directly from an employer and not made through an EAF?*

It depends. If the payment meets the definition of a qualified disaster relief payment under Section 139 for qualified disaster expenses that are not otherwise covered by insurance or other reimbursements, such payments are not subject to income tax, self-employment tax, or other employment taxes even if made directly from an employer.

*Are donations to an EAF tax-deductible?*

If recognized by the IRS as a Section 501(c)(3) organization, donations by individuals or corporations to an EAF may eligible as a deduction as a charitable contribution under Section 170. Changes included in the recently enacted Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") includes expanded Section 170 deductions for both individuals (itemizers and non-itemizers) and corporations.

*Are there restrictions on EAF payments to individuals?*

Yes, particularly when made by an EAF structured as a donor advised fund or a private foundation that are limited to Section 139 qualified disaster relief payments. As relevant to payments from an EAF, qualified disaster relief payments are defined in Section 139(b) to include any amount paid (regardless of the source) for the benefit of an individual:

- to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster;

- to reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence or repair or replacement of its contents to the extent that the need for such repair, rehabilitation, or replacement is attributable to a qualified disaster; and
- by a person engaged in the furnishing or sale of transportation as a common carrier by reason of the death or personal physical injuries incurred as a result of a qualified disaster.

Qualified disaster relief payments do not include payments for expenses paid for by insurance or other reimbursements, or income replacement payments, such as payments of lost wages, lost business income, or unemployment compensation.

*Can an EAF provide assistance to other businesses?*

It depends, but an EAF structured as a public charity likely has the most latitude to provide financial assistance to other businesses as it is not limited to qualified disaster relief-type payments. For example, a charitable organization may provide assistance to a for-profit business if the assistance is a reasonable means of accomplishing a charitable purpose (e.g., relief of the poor and distressed or lessening the burdens of government), and any benefit to private interests is incidental to the accomplishment of such charitable purpose.